How to Combine Public Spending with Fiscal Rigour?

‘Austerity by Stealth’ in Post-Bailout Portugal (2015-2019)

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Abstract

In this article, we argue that the Costa I Socialist government (2015-2019) managed to combine responsiveness to voters with responsibility towards domestic and international actors by pursuing some kind of ‘austerity by stealth’, which we define as less visible fiscal contraction that is not displayed by the government in its public discourse. The radical left parties implicitly agreed with this strategy in exchange for the adoption of a long list of visible anti-austerity policies. This allowed the Costa I government to fulfil its electoral pledges and maintain the support of the radical left on the one hand, whilst also reducing the country’s deficit and consequently the costs of interest-debt repayments.

Keywords

Budget, Austerity, Socialist Party, Radical Left, Costa, European Union, Contract parliamentarism

Introduction

The legislative election of October 2015, one year after Portugal had exited the bailout programme, saw the electorate shift to the left. The election was formally won by the incumbent centre right coalition, while the Portuguese Socialist Party (*Partido Socialista*, PS) obtained a positive yet disappointing score (of + 12 seats) and the forces of the radical left – which had previously strongly opposed the austerity measures both in parliament and on the streets – were rewarded by voters. Neither the rightist coalition nor the PS obtained an absolute majority of seats. After lengthy negotiations and the defeat in parliament of a new tentative centre right government, the PS of António Costa succeeded in forming the first minority government formally supported by the three Portuguese radical left parties: the Left Bloc (*Bloco de Esquerda*, BE), the Portuguese Communist Party (*Partido Comunista Português*, PCP) and the Greens (*Partido Ecologista - Os Verdes*, PEV).

Both commentators and rating agencies were concerned that the new Costa government - initially known by the derogatory name of *Geringonça*[1] (contraption) - would not be able to maintain budget discipline.[2] Moreover, few observers would have predicted at the time that the government would reach the end of the legislature (Barros 2019). However, Costa not only stayed in power for the four full years, but he also managed to successfully conjugate two things thought to be totally incompatible during this legislative term (2015-2019): anti-austerity rhetoric (and policies) and pro-EU stances. Indeed, the government managed to reverse several public spending cuts, halve the unemployment rate, bring the budget deficit to its lowest level in 45 years (Wise 2019) and regain credibility in the markets and at EU level. What is more, the government maintained the external support of the three radical left parties throughout the whole legislature despite their mild Euroscepticism and programmatic distance from the PS (Lisi 2016; De Giorgi & Cancela 2019). Finally, in October 2019, the incumbent PS was also able to (re)gain the confidence of the Portuguese voters and was the major winner of the legislative election with 20 more seats in parliament than in 2015.

[1] The term 'Geringonça' appeared for the first time in the Portuguese newspaper *Público* in August 2014 to describe the Socialist Party in the campaign for the primary election that opposed António Costa to António José Seguro. The term was later used by the CDS-PP President, Paulo Portas, in a parliamentary debate to describe the PS minority government supported by the radical left (Barros 2019).

[2] Portugal divided by austerity, Financial Times, 1st December 2015, https://www.ft.com/content/4a0a2c44-8489-11e5-8095-ed1a37d1e096

This success could be interpreted as resulting from the Portuguese government's capacity to respond to 'several principals' (Laffan 2014) as well as to one co-agent. Indeed, given the increasing European and global constraints, parties in government have become 'agents with two principals', that is, delegates of two different subjects: the voters and the European and financial institutions, which sometimes bear conflicting interests (Bardi, Bartolini & Trechsel 2014; Laffan 2014). As the Socialist Party simultaneously met the country's European commitments and fulfilled its electoral pledges to revert many austerity policies (Moury, Cardoso & Gago 2019), it seems to have adequately responded to both its principals. Additionally, it did so by ensuring the support of the radical left - i.e., its 'co-agent' - which was vital for the executive's survival until 2019.[3]

According to some observers,[4] Costa's triple success was made possible thanks to the boost to demand and production and the fall in unemployment associated with the reversals of the austerity policies. In this article, we argue that this narrative is not entirely accurate and present a three-fold argument. First, we argue that deficit reduction and spending increase within budgetary limits were made possible because the government continued austerity, albeit more discreetly (what we call 'austerity by stealth'). These measures enabled the Portuguese government to reduce the country's deficit in line with the European Monetary Union (EMU) ceilings and, by the same token, to gain credibility with investors. Such an outcome further decreased the cost of interest-debt repayments - which were already lower thanks to the European Central Bank (ECB)[5] - and also gave enough fiscal space to relax the austerity by stealth in the second part of the legislature. Finally, we contend that these measures were accepted by the radical left parties in exchange for the approval of important and visible austerity policy reversals which, following Branco and al., we define as policy changes aimed at neutralising or limiting (temporarily or permanently) the aim of a specific policy (2019, p. 207). We apply the concept of policy reversal to measures enacted in Portugal in the period 2011-2014.

To support our arguments, we rely on a combination of different methods: a number of in-depth interviews to PS government members and radical left MPs, an analysis of the data

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[3] Even though this government solution was not re-confirmed after the last election and the Socialist Party now governs as a minority without any explicit parliamentary support.

[4] See for example Les échos, 18.07.2017: Portugal's Economic Miracle Makes A Case Against Austerity; the New York Times, 22.07.2018: Portugal Dared to Cast Aside Austerity. It's Having a Major Revival; the Financial Times, 10.05.2019: Portugal: a European path out of austerity?.

[5] The ECB started buying assets from commercial banks in March 2015 as part of its non-standard monetary policy measures. These asset purchases are also known as quantitative easing or QE.

related to the government spending in its four years in office; and an in-depth examination of the status of the Health Sector. The paper is thus divided into four sections: the first establishes the theoretical basis of our argument; the second sets the scenes and focuses on the different strategies implemented by the government to achieve its twofold objective – reverting austerity and respecting EU constraints – without upsetting either of its political partners or the markets. The third section analyses the evolution in the government's revenue and spending - with a subsection on the specific case of the National Health System (NHS). A fourth and final section concludes.

Theoretical Framework: Government's Instruments to Square the Circle

Austerity by Stealth

After a period of austerity, parties that campaigned for change find themselves in a tricky situation if they are elected. They have two somehow contradictory interests. On the one hand, they need to satisfy their voters by implementing such a platform. On the other, they have strong incentives to appear credible to investors and respect their international commitments (Moury & Afonso 2019); achieving such goals allows more influence to be gained internationally and/or money to be saved on high interest rates and, in the Eurozone, pecuniary sanctions to be avoided. In Peter Mair's eloquent words, governing parties need to be both "responsive and responsible" (Mair 2009).

Whereas Peter Mair claimed that these were increasingly incompatible goals, we argue that governing parties have a strategy available to them that is both responsive and responsible. This strategy consists of *visibly reverting some austerity measures (and claiming credit for this), while at the same time keeping or even extending less visible cuts and taxes (but not displaying it in public discourse)*. We call this strategy 'austerity by stealth'.

This argument locates itself in a solid body of research that contends governments have incentives to claim credit for popular policies while concealing the implications of less popular choices from voters. For example, welfare state scholars have long shown that programmes susceptible to non-transparent reforms are more likely to be cut than other programmes (Pierson 1996; Lindbom 2007). In a similar vein, Mesa-Lago & Muller (2002) show that policymakers in several Latin American countries concealed the harmful changes associated with pension reforms, drawing public attention to the more visible benefits (see also Carolo 2014 for pensions reforms in Portugal). Exworthy, Macfarlane & Willmott (2009) also demonstrate how the British government obfuscated the reforms of the National Health System.

This strategy has also been studied by economists, in the fiscal sphere. For example, scholars have observed a governmental strategy of 'fiscal illusion' or 'fiscal obfuscation', which means hiding how much citizens pay for the state (for a review see Dollery & Worthington 1996). The main finding of these studies is that a complex tax system helps the government increase public expenditure without taxpayers being fully aware of what is happening (Dell'Anno & Mourao 2011; Sanandaji & Wallace 2010).

A third strand of the literature of relevance to our argument concerns public investments, a category of spending that is often less visible than others in the short term. Statistical analyses show that when fiscal consolidation is required, investment goes down more than other spending categories (see amongst others Breunig & Busemeyer 2012). This is not only true for countries that must respect EMU ceilings, but also for those outside the Eurozone (see for example Stancík & Valila 2012). The reason invoked to justify such findings is that public investments are less visible than other expenditure, and hence easier to cut back or postpone (Oxley & Martin 1991, p. 161). Another explanation is that, for some investments, it is companies and not voters that are most affected by the cuts in the short term and parties are more sensitive to the latter when an issue is salient. Studies by Kraft (2017) and Jacques (2019) tested this argument by distinguishing between types of investment, arguing that investments with visible short-term benefits for citizens are more resilient than others. Using different methods, both scholars demonstrate that fiscal pressure makes incumbents cut back on the infrastructures and innovation that most affect companies and universities, rather than on spending related to human capital.

Finally, scholars interested in the consequences of a bailout for public policy also present interesting findings for our argument. The idea is that spending reversals have costs (lack of budgetary revenues, damaged credibility or EC sanctions) and governments are more likely to reverse policies when this brings an electoral payoff (Moury and Afonso 2019). In that line, Rickard & Caraway (2019) demonstrate that public sector wage cuts made under IMF conditionality do not persist in the longer term because governments are keen to appease powerful domestic constituents. Moury, Cardoso & Gago (2019) show that two thirds of the spending cuts introduced in Spain and Portugal during the crisis have been reversed, and these reversals were mainly to policies with concentrated benefits and diffuse costs. Finally, Afonso & Bulfone (2019) show how political parties' proposals for reversals are linked to the interests of their core constituencies. All these studies converge into finding that when governments are forced to make budgetary choices, they will maintain (or increase) visible spending and make cuts in less visible areas.

The Positive Loop

Practising 'austerity by stealth' is not without risk for incumbents, however. First, the opposition and interest groups, who are more informed than ordinary voters, can benefit from alerting citizens about the hidden cuts, especially if they had not been involved in introducing the policy (Elmelund-Præstekær, Klitgaard & Schumacher 2015). Another problem is that under-investment or cuts in less costly areas cannot be kept invisible forever. Firstly, users may notice the degradation of the infrastructures (hospital buildings, classrooms, public transports etc.) or the deteriorating access to/quality of public services. Also, under-investment reduces growth: for example, Abiad, Furceri & Topalova (2015) used a sample of 17 OECD economies since 1985 to show that a lack of investment decreases growth, restricts private investment and reduces employment.[6] Additionally, a lack of investment in public services is visible to the specific constituencies that would have benefited from it (Kraft 2017; Jacques 2019).

The last point of our argument, however, brings a more positive outlook. We argue that 'austerity by stealth' ultimately creates a positive loop that enables a partial relaxation of this austerity. This is because some degree of hidden austerity allows for a reduction in the deficit that helps boost credibility among investors (and, in the Eurozone, avoid EU sanctions at). Governments issue bonds to borrow money for short-term or long-term loans at varying rates of interest (yields). The more investors fear the government will default on its debt repayment, the lower the demand for these bonds will be and the higher the yields. Given the substantial size of most government debt burdens, a decrease in bond prices entails significant real savings for the government, which might then be used to (partially) compensate for those hidden austerity measures.

[6] Similar findings were found by Dreger & Reimers (2016) and Fournier (2016), among others.

Many other factors impact investors' trust in sovereign bonds, such as elections and the ideology of the incumbents (Ferrara & Stalter 2018), fiscal policies (Tavares 2004), government budgetary plans (McMenamin, Breen & Muñoz-Portillo 2015), concentration of power within the political system (McMenamin & Breen 2013), appointment of technocrats (Alexiadou, Gunaydin & Spaniel 2018), membership of international organisations (Gray 2013), delegation to supranational actors (McMenamin & Breen 2013), and the EU declarations and actions of the ECB (Demertzis & Wolff 2016).

This literature generally converges in affirming that (variation in) fiscal deficits,[7] debt and inflation (in economics, the 'fundamentals') are the most important determinants of the government bond yields. To put it simply, the lower the deficit, debt and inflation, the greater the demand for sovereign bonds will be and the lower the yields (see amongst others McMenamin & Breen 2013). In the first years of the EMU, investors in the EMU did not scrutinise these fundamentals closely, and yields were low for all countries. However, investors lost confidence in the ability of some countries to repay their debts when the manipulation of Greece's public account data in 2009 was revealed, and variation in deficit and debt has since become an important determinant of the yields of sovereign bonds yet again (Wollmershäuser & Klepsch 2011; Poghosyan 2014).

Based on these findings, we thus argue that the reduction in the deficit obtained thanks to austerity by stealth allows a given country to regain credibility vis-a-vis investors and that the associated decrease in borrowing costs might have allowed a (partial) relaxation of this type of austerity nearer to the elections. This partial improvement increases (slightly) the satisfaction of the users of public services and of organised interests; and makes it more difficult for opposition parties to criticise the government for continued austerity measures.

The Portuguese Case: 'Contracted Austerity by Stealth'

Applying our argument to the Portuguese case, we claim that the Costa I government managed to 'square the circle' of reverting many spending cuts while continuing to reduce the deficit (Fernandes, Magalhães & Santana-Pereira 2018, p. 512) not simply due to the (rather timid) economic recovery (Blanchard & Portugal 2017) but also because it continued to pursue some kind of austerity, albeit less visibly than before.

[7] Together with inflation, which is no longer the responsibility of national governments within the EMU.

One further issue arises from this argument, however: if the Portuguese government pursued austerity by stealth, how did it manage to maintain the support of the radical left parties? To varying degrees, these parties did not endorse European rules and, as they were not formally in government, felt to some extent free of responsibility.

We argue that the mechanism enacted to allow the PS to pursue austerity by stealth was that of the so-called ‘contract parliamentarism’ or contract minority government (Aylott & Bergman 2004; for Portugal see De Giorgi & Santana-Pereira 2016; Fernandes, Magalhães & Santana-Pereira 2018; De Giorgi & Cancela 2019).

In contract parliamentarism, minority governments ‘have relationships with their ‘support’ parties that are so institutionalised that they come close to being majority governments’ (Bale & Bergman 2006, p. 422). The party in government signs ‘an explicit written contract’ with one or more party groups that remain outside the cabinet but give external support to the executive. The agreement usually has the following basic characteristics: it commits the partners ‘beyond a specific deal or a temporary commitment’ and is ‘available to the public’ (Bale & Bergman 2006, p. 424). Not only should these characteristics help the party in government maintain the support of the smaller parties through the exchange of policy gains, but they should also enable the supporting parties to influence the content of government policies. As the agreements are public, the pledges within them and their relative fulfilment can be tested by both the electorate and the parties themselves.

In addition to compromises reached in specific areas, as seen in Sweden in 1998 and 2002, in New Zealand in 2005 (Bale & Bergman 2006, p. 436), and in many coalition countries (Timmermans 2006; Moury 2013), a written agreement also implies that partners ‘agree to disagree’. This means that the partners do not commit to cooperate on issues that are not included in the pacts, but they accept their partners’ stances on these issues. In other words, written agreements involve a pact of non-aggression on those other issues.

We thus argue that the Costa I government managed to pursue austerity by stealth because it made a commitment to pass a series of visible anti-austerity policies through written contracts with the radical left and, in exchange, the latter implicitly accepted the EU constraints. In other words, our third argument is that ‘austerity by stealth’ was in some way part of a contract with the radical left, which, in exchange for a rapid reversal of visible austerity policies, made an implicit deal to respect Portugal’s European commitments, such as keeping the general/structural deficit below 3 per cent/0.5 per cent of Gross Domestic Product (GDP).[8] Hence, the radical left parties tacitly accepted that the costs of the reversals would, if necessary, be covered by less visible spending cuts and/or tax increases.

Setting the Scene

The Portuguese Bailout and its immediate aftermath (2008-2014)

In May 2011, the Portuguese authorities signed two MoUs (one with the European Union and another with the International Monetary Fund), in which they committed to a series of reforms in exchange for a €78 billion bailout. The MoUs' foresaw actions on deficit reduction (notably by cutting spending in education, pensions and health; lowering transfers to regional and local authorities; and reducing public sector employment); competitiveness (reduction of severance payments, labour reforms and liberalisation of the public sector); deleveraging of banks and reforms to the judicial system. This programme was largely implemented to by the right-wing PSD/CDS-PP coalition, elected a few weeks after the signature of the MoUs (Moury and al. 2020), under the supervision of the troika (European Commission, IMF and the ECB).

During the bailout, GDP growth plummeted and government deficits soared (Guillen and Pavolini 2015). Unemployment rose dramatically and the provision of public services was considerably weakened (Petmesidou and Glatzer 2015). This deterioration had dramatic consequences in a country with a 'dualist' welfare state – that is with peaks of generosity for some groups and residual protection for others (Ferrara 1996). To some extent, the reforms that the troika pushed for moderated the privileges of some and therefore reduced inequality (Perez and Matsaganis 2018). However, those who were already very vulnerable were further impoverished. For example, social protection was considerably weakened. Others have also noted that the cuts in public services led to a serious reduction in access, equity and the quality of health services (Petmesidou & Glatzer 2015).

[8] The Fiscal Compact obliges ratifying member states to keep their general budget deficit below 3.0 per cent of the GDP, and their structural deficit below their Medium-Term budgetary Objective (MTO) which can be set to a maximum of 0.5 per cent of GDP for states with a debt-to-GDP ratio exceeding 60 per cent – or a maximum of 1.0 per cent of GDP for states with debt levels within the 60 per cent limit.

In May 2014, Portugal exited the programme but remained under an excessive deficit procedure until June 2017; this procedure entails closer scrutiny of the country's actions and failure to meet the goals and deadlines set by the Council can lead to sanctions. Although Portugal's bond yields remained high, they were lowered following the programme of quantitative easing which the ECB Governing Council introduced a few months later, in January 2015 (Hodson 2015). When elections were held in October 2015, the ten-year yield had exceeded 3 per cent. By the end of the year, growth was positive for the first time since the bailout, public debt was over 130 per cent and the public deficit was slightly higher than 3 per cent (see Figure 1).

The (Implicitly) Contracted EU Commitments and Austerity by Stealth

In the 2015 election, the centre right parties together obtained more seats than the PS and could therefore defeat it in any vote in which the three radical left parties abstained or voted against. After a first period of negotiations, the President of the Republic nominated the incumbent PSD leader Pedro Passos Coelho as *formateur*, despite the evident lack of a parliamentary majority. The new government fell after less than two weeks following a motion of censure supported by all the left-wing parties (De Giorgi & Santana-Pereira 2016). The left parties' desire to avoid a second right-wing government then paved the way for a minority government led by the Socialist António Costa and supported, for the first time, by the radical left (Lisi 2016).

It should be noted that the three radical left parties clearly chose not to share office with the PS, despite the socialists reiterating the invitation to do so. The decision was probably due to the parties trying to limit potential criticisms from their respective electorate, and they were able to maintain this position as they were numerically essential for the formation and survival of a socialist government. Such an alliance was also facilitated by the PS' clear stance against austerity during the campaign. For instance, in a letter published in the newspaper *Jornal de Negócios* in August 2015, António Costa had affirmed that the austerity adopted by the incumbent in the previous years had not been fruitful and a reversal of the trend was necessary:

'Despite brutal austerity and enormous impoverishment, we have not grown more, nor do we owe less. (…) We are no longer at the stage of asking whether it is possible to break with austerity, but at a time to say that the austerity page needs to be turned'.[9]

The PS leader's aversion to austerity was evident in public discourse and helped in the negotiation phase after the election, in which the PS discussed and finally signed three bilateral (but similar) agreements with the Left Bloc, the Communist Party and the Greens. The agreements were interpreted as fulfilling the office and policy goals of the socialists and the radical left respectively (Lisi 2016; De Giorgi & Cancela 2019).

Taken together, the agreements contained over a hundred specific commitments to revert policies to the pre-crisis status quo as well as to adopt various new policies (De Giorgi & Cancela 2019; Fernandes, Magalhães & Santana-Pereira 2018). It is true to say that many of these policies were temporary and supposed to be reverted as soon as the situation improved (the 'extraordinary' income and pensions taxes and civil servants' pay cuts). In some cases, this was even a legal obligation after a constitutional Court ruling and, here, the Socialist and radical left parties only disagreed on the speed of the reversals and were able to find a compromise. Finally, there was a list of issues on which all the parties agreed that action was necessary but did not share a common position on the specific type of action.[10]

According to our interviewees from the PS and the radical left, negotiations with the BE and the PCP and PEV occurred in two different ways. The leader of the BE, Catarina Martins, had specified during a debate in the electoral campaign that the PS should abandon three specific pledges of its electoral manifesto if they were to enter into negotiations, namely on pensions, the labour code and funding of social security (Botelho 2019). As the PS accepted this condition, negotiations started even before the election and an understanding was reached. With the PCP and PEV, negotiations only started after the elections and were more about listing points of agreement (Interview 3). As a negotiator from the PS explains:

[9] English translation from 'Carta de António Costa: Virar a página da austeridade, relançar a economia', *Jornal de Negócios*, 27 August 2015: https://www.jornaldenegocios.pt/opiniao/colunistas/detalhe/carta_de_antonio_costa_virar_a_pagina_da_austeridade_relancar_a_economia

[10] For instance, 'defending the social functions of the state and public services, social security, education and health, promoting a serious fight against poverty and social and economic inequalities', as stated in all the three agreements signed, without specifying how to reach such objectives.

‘With the PCP, it was as if we were mentally building a column where we converged, and a column where we diverged, and then we would decide the degree of convergence depending on the weight of each column’ (Interview 3).

Although the PS certainly insisted during the negotiations on the need to respect the European rules on the deficit and debt reduction (Interview 3), no joint position on the EU, Euro and debt renegotiation was included in any of the agreements (PS & BE 2015; PS & PCP 2015; PS & PEV 2015). According to our interviewees, this was a very delicate topic that was dealt with very cautiously. On the PS side, negotiations were opened by saying they intended to comply with the European rules and all the recovery measures had to be achievable within that limit (Interview 1, 3, 5). On the other hand, the radical left acknowledged the PS commitment to European rules but refused to be bound by them. As an interviewee from the BE told us, for example: ‘The European commitments of the Socialist Party were well-known to us, but the agreements did not turn the PS commitments into the Left Bloc’s commitments’ (Interview 5). Nevertheless, several references are made to the need to respect the European rules in the governmental programme that was presented and discussed in parliament (Governo Constitucional 2015).

The first state budget was the most difficult to approve (Interview 1). Its first draft was presented in February 2016 and included several reversals of the policies approved by the previous centre right government. For instance, the income tax surcharge (for higher incomes) was abrogated and additional tax brackets were reintroduced, while pre-bailout working hours, salaries and bonuses in the public sector were reinstated – although their increased contribution to a special health insurance was maintained (for a list of reverted policies see Moury, Cardoso & Gago 2019). As a result, the EC warned that the deficit would be excessive, and that Portugal’s level of competitiveness was in danger. The news was received by the government with concern, not only because Portugal was still subject to an excessive deficit procedure but also because ministers saw a causal relationship between the EC budget assessment and that of investors (Moury et al. 2020). As a former junior minister (*secretário de estado*) explained to us:

‘One of the reasons why we want[ed] deficit targets to be met and accepted by the EC is that we want[ed] to reassure the financial markets. A country like Portugal gains a lot from having the EC saying "yes sir, this is an acceptable pace of deficit reduction". So, let's say that the concern about the way markets react to our goals is an integral part of our goals’ (Interview 2).

According to our informants, although the radical left parties were sceptical about the role investors ought to play in politics, the argument employed in negotiations with them was that it was important to appear credible to investors (Interview 2). The solution for the 2016 budget found by the negotiators, and accepted by the radical left, was to cover the increase in expenditure by raising revenues through higher taxes on alcohol, tobacco, vehicles and banking contributions (Moury et al. 2020). As a result, the state budget was approved by the PS, BE, PCP and PEV for the first time in Portuguese history.

In the successive budgets, reversals continued and were deepened or completed, distributing benefits to crucial constituencies of all the parties involved (Fernandes, Magalhães & Santana-Pereira 2018; Moury, Cardoso & Gago 2019). Among others, the government and its partners further increased the lowest level of pensions and social allowances and re-established the pre-bailout conditions for these benefits and the possibility of progressions in the civil service. By the end of 2016, Portugal's economic context was improving as growth started to pick up and yields to decline. Thanks to this, the deficit went down and Portugal exited the excessive deficit procedure in June 2017, moving from the corrective to the preventive arm of the Stability and Growth Pact (Moury, Cardoso & Gago 2019).

Our interviewees pointed out that reaching the 2 per cent deficit for 2016, an even lower point than forecasted and the lowest in 40 years, was fundamental to prove their capability and regain credibility with the EC and the investors:

'There is no doubt that there is a sort of stigma in having an adjustment programme to accomplish. But it is not insurmountable. It is something that can be overcome with credibility and realistic actions. The idea is not to promise a lot and then fall short. It is better to promise what you think you can achieve and then do better' (Interview 4).

In line with our second argument, interviewees reported that regaining the confidence of investors (together with the quantitative easing of the ECB), and the related gradual reduction in yields, permitted important budgetary savings. As explained in detail by one of our interviewees:

'We were criticised by the Left Bloc and the PCP because we had reached the 1.4 [deficit] that was already very low and did not invest this money in public utilities, like the NHS. But the truth is that achieving that allowed us to put public debt at very low interest rates, and this was good because it allowed us to save money on interest' (Interview 3).

Just as in the campaign, this fiscal consolidation was not publicly acknowledged. On the contrary. For instance, in an interview with the Spanish newspaper El País in late 2017, the Minister of Economy at the time, Manuel Caldeira Cabral, stated that the government had simultaneously 'ended austerity' in Portugal and regained the investors' confidence. 'We freed the economy from the austerity strings. We ended austerity and adopted a moderate and responsible policy, returned income to workers and pensioners and ensured that citizens would no longer have cuts'.[11] Similarly, during the PS Congress in May 2018 when António Costa was re-elected Secretary General, he stated yet again that his government 'proved it is possible to turn the austerity page without leaving the euro'.[12]

Finally, it must be noted that researchers calculated that about 90 per cent of the concrete commitments in the PS-radical left agreements were implemented by the end of 2018 (De Giorgi & Cancela 2019). Most of the pledges that were not fulfilled at the end of the term involved large investments in different areas – for example, improving users' access to the National Health Service and the modernisation of the train services (De Giorgi & Cancela 2019) – a finding that tentatively supports our first argument.

To conclude, it was essential for the government to sign a contract with its supporting parties in order to reach its objectives, i.e. to conjugate two things that were thought to be incompatible: anti-austerity policies (albeit with the limitations that we have mentioned), and pro-EU stances. The respect of the EU rules was not in the contract, but all the left parties gave it their implicit agreement. Austerity by stealth allowed the government to ensure credibility among the EU institutions, the markets and the investors and led to a reduction in yields and an increase in the government's room for improvement in the successive budgets, generating the positive loop that took the country out of the crisis and touching zero deficit in 2019. Less visible tax increases or budgetary cuts were tolerated by the radical left in view of the accomplishment of other policy gains, which also proved to be positive for the PS in the next election campaign.

[11] English translation from 'Caldeira Cabral: "Portugal va tener el mayor crecimiento del siglo"', El Pais, 3 September 2017:
https://elpais.com/economia/2017/09/01/actualidad/1504268115_641533.html).

[12] English translation from 'Provámos que é possível virar a página da austeridade sem sair do euro', TVI24, 26 May 2019:
https://tvi24.iol.pt/videos/politica/provamos-que-e-possivel-virar-a-pagina-da-austeridade-sem-sair-do-euro/5b08a0a30cf2c09c9a16589f

A Quantitative Analysis of Government Spending and Revenue

In this section, we show how the choices above were translated into macro-economic outcomes. We show that although the government reverted several austerity policies, there was no inversion of the fiscal contraction in effect since the crisis. Additionally, we look at the consequences of this trend in terms of public services offered to citizens in the health sector.

Public Debt

In Figure 1, we show the results of those trends in terms of public debt and deficit (as a percentage of GDP). We can see that the Government was in constant decline from 2011 (the first year of the bailout), reaching 1.9 per cent in 2019. Public debt stabilised after 2013 but decreased after 2017. This shows that the Costa I government was indeed responsible for its EU commitments. The ratio of public debt to GDP fell in the last years of the Costa I government as a result of GDP growth being larger than nominal debt increases. The decline in the public debt interest rate contributed significantly to this evolution, due to both international market conditions and the steady improvement in the Portuguese Government's reputation.

Revenues

Fiscal consolidation can be achieved by an increase in taxes and/or a decrease in spending. Starting with the former, Figure 2 depicts the amount of direct and indirect revenues of the Portuguese government from 2007 to 2019, together with the total revenues and the evolution of GDP. We present absolute values at constant prices (the reference year is 2016). Although these figures are traditionally presented as a percentage of GDP, we prefer to present absolute numbers given the marked variation in growth rate during the period under study. However, we add the total GDP to the graph to show how this variation compares with growth in revenues. Both the numerator and the denominator in the usual ratio changed during this period.

In this figure, we can see that GDP started to grow from 2014 onwards, following 7 years of small or even negative (during the bailout years) growth. Looking at total state revenues, we see that after decreasing from 2008 to 2012 they rose gradually until the end of 2019 (to higher than the pre-crisis level). In other words, there is no indication of a relaxation of fiscal consolidation on the revenue side during the first mandate of the PS, despite an increase in GDP.

A closer examination of the sub-categories of revenues shows an even more interesting picture. On the one hand, we observe that the revenues from income tax, which had risen remarkably in 2013, tended to decrease slightly after the elections (despite the growth in employment and as a result of an increase in the number of tax brackets, which made taxation lower and more progressive as described above). Corporate tax revenues remained stable after the bailout due to the contrasting effect of both a change in the tax rate (which was lowered from 25 per cent to 23 per cent in 2014 and to 21 per cent in 2015) and the increase in economic growth.

On the other hand, revenues from indirect taxes grew more than GDP during the Costa I government as taxes on petrol, sugary drinks, and net worth were raised, while VAT rates that had gone up during the crisis were maintained (except for the taxation on restaurants). Taken together, these results provide support for our austerity by stealth argument: in addition to the relative weight of taxation not going down during the Socialist government, there was a clear shift from visible (income) to less visible (indirect) taxation.

Expenditure

In Figure 3, we turn to Government expenditure. We present the evolution of the most important categories of government spending (in constant prices) since 2007. To understand this evolution, it must be noted that there was no privatisation of public utilities in these sectors contrary to what happened to public spending in transportation, energy and communication, for example.

In the figure, we observe an abrupt increase in expenditure on interest rate payment in 2010-12. After Draghi declared his intention to buy national bonds on the secondary market in 2012, the spending on interest rates stabilised for three years. The expenditure on interest rates then went down slightly after 2015 when the BCE started its quantitative easing programme, but this decline became more marked after 2016 when the Government deficit started to decrease. Even though it is very difficult to disentangle the effects of the BCE interventions and reduction in Government deficit, the sharper decrease in interest payments in 2017, 2018 and 2019 supports our second argument, namely, that the reduction in Portugal's deficit reassured investors and allowed for considerable savings in interest payments. In the case of social security, there had been a counter-cyclical increase during the 2010-12 period (as a result of unemployment), and again a stable pattern from 2013.

The same figure also shows the sharp decrease in total state expenditure and the total spending on education, investment and health in 2010-2012/3, before becoming more or less stable. In other words, we do not observe any increase in spending in absolute terms (or welfare state expansion) relative to post bailout. If we look at the evolution of GDP, we then can see that the evolution of spending has not accompanied the increase in GDP that started in 2014. In other words, public expenditure as a percentage of GDP declined during the Costa I government.

The most striking feature is the decrease in spending on investment in real terms (and thus the even greater decline as a percentage of GDP since 2014): there had been a dramatic fall in the period 2010 to 2012, which subsequently continued. This is a worrying trend as economists generally agree that public investment tends to foster long term growth, to such an extent that it 'pays for itself' and more (see for example Abiad, Furceri & Topalova 2015). This trend has been observed for both 'hard' (infrastructure) and 'soft' (education, R&D, family support, and active labour market policy) public investment (Streeck & Mertens 2011) in other countries (Hickey, Lozej & Smyth 2018; Hauptman 2018). Moreover, this decline cannot be explained by a closing of public-private partnerships, which are long-term contracts between government and a private-sector company to finance, build, and implement projects (Direção-Geral do Tesouro e Finanças 2012).

However, in line with our positive loop hypothesis, we observe a slight increase in absolute spending the year(s) before the election in two sectors: investment and health. The symmetrical (but larger) fall in interest-rate payments therefore allowed for both this increase and the reduction of the deficit that we observed in Figure 1.

To conclude, we find no evidence of the reversal of austerity on either the revenue or expenditure side. On the contrary, we observe an increase in government revenues and a stabilisation of expenditure at the post bail out level (that implies that the expenditure in percentage of GDP fell). As expected, despite the government's public statements (see below), its strategy has been to shift from more visible to less visible austerity – namely with relatively more indirect taxation and a significant decrease in investment.

Austerity by Stealth in the Health Sector

The absolute figures for spending and expenditure do not tell us the whole story. Indeed, these numbers do not account for the fluctuation in population, wages, prices and costs that occurred during and after the bailout. To address this limitation, we now turn to a more fine-grained analysis of one key sector of the state, the provision of health services. This area was chosen as it represents the state's major area of spending but also of great importance to the Portuguese. It is also very important to the Portuguese: in a poll conducted just before the 2019 election, a quarter of the respondents considered health the most important issue facing the country.

Since 2007, there have been dramatic changes in expenses in the health sector. On the one hand, the immediate impact of the bailout was a drop of circa 14.5 per cent in public health care expenditure in 2012 (the lowest point) vis a vis 2010 (the highest point). Several measures were taken to cut nominal public health care expenditure (Barros 2012). After a first set of measures directed towards civil servants, including wage cuts and an increase in working hours, pharmaceutical spending was the next target; the regulated margins of pharmacies in prescription-only drugs was revised down, a new less costly system of international reference pricing for drugs was introduced as well as health technology assessment methodologies for new pharmaceutical products. Finally, a more diverse bundle of measures sought to increase the efficiency (and lower the costs) of health care delivery (including centralised procurement initiatives, imposition of price reductions on service and product providers, better management of human resources, etc.). With the end of the bailout period and the change in government, the first set of measures affecting the wages and working hours of NHS workers was gradually reversed. Also, new pharmaceutical products, introduced mainly in the hospital market, have considerably higher prices than the products in the same therapeutic class that had previously been introduced. There is now less pressure to contain the new prices.

We examine the effects of these changes from four different angles. We first present a statistical analysis of the trends in different categories of expenditure, before making a detailed analysis of the evolution of the hospital debts, the waiting list for various procedures and the citizens' perception of whether their needs are met.

In the statistical analysis of the *trends* in expenditure in different indicators of health services, we distinguish three distinct time periods: before the bailout (2000-2011), during the bailout (2011-2014) and after the bailout (post-2014). We use a simple regression model to compute mean effects:

$$x_i = a_o + a_1 t \times D_1 + a_2 t \times D_2 + a_3 t$$

where t represents a time trend variable, D_1 takes value 1 during years 2011-2014, value 0 otherwise and D_2 takes value 1 during years 2015-2017 (or later) and value 0 before 2015. a_1 and a_2 coefficients represent the change in a given indicator during the bailout period and afterwards, respectively. Hence, coefficients should be interpreted as deviations from the previous time trend evolution. The small number of years implies that this exercise should be seen primarily as a useful description of the main features of this period.

If neither coefficient is different from zero, there has been no change in trend since the initial period. Negative/positive coefficients imply that austerity/fiscal expansion is at play in a given period. When both coefficients are negative, if a_1 is inferior (more negative) / superior to a_2, it could be said that austerity was attenuated / aggravated (respectively) in the later period.[13]

To put it simply, the analysis is based on the idea of deviations to a trend. The growth of spending in a given category during the troika period (2012-2014) and after (2015-2017) is measured against the trend of growth before the troika (2000-2011). The next table summarises the main results of the regression analysis as described by the equation above.[14] In Table 1, we observe that austerity in the health sector took place during the bailout years, but subsequently continues: if we consider the total public health expenditure,[15] we can see that $a_1$and a_2 are negative and statistically significant - which means there was a downward trend in expenditure as compared to the previous period.

Cuts in public expenditure can result from cutting services, costs and prices and shifting payment from the public sector to households. We therefore identify the trends in a in a range

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[13] The interpretation is as follows: $(a_1-a_2) > 0$ - increase in x during the troika was larger than after the troika; $a_1=a_2$ it is the same; $a_1 - a_2 < 0$ - increase in x during the troika was smaller, impact of troika was larger => thus $a_1 < a_2 < 0$ (a_1 inferior to a_2) means lower impact during period 2 (after troika) than during period 1 (troika).

[14] The number of observations is 18, with 14 degrees of freedom.

[15] Including both the National Health Service and the Regional Health Services of Azores and Madeira autonomous regions. The analysis is performed in nominal terms (during this period, inflation was generally low, and evolution of out-of-pocket payments was driven by both price and volume effects). A revision in the statistical series of the National Health Accounts was made, and the values for 2016-2017 were reviewed upwards relative to the previous series. We do not have further backward compatibility. The main computations above used the old series.

of different expenditures. We look at all the sub-types of expenditure for hospital care and we observe fiscal contraction during the bailout, but also for inpatient and outpatient care in the post bailout; on the other hand, neither the bailout nor its termination had a significant impact on the expenditure trend for daycare. Similarly, there was a negative shift in the trend in spending on pharmaceutical goods for both the bailout and post bailout periods.

We can assess whether households had to cover an increasing part of the bill by looking at the evolution of out-of-pocket payments, i.e. the sum paid by citizens and not reimbursed by the NHS, including the user charges in hospitals, cost-sharing for drugs, etc. To recall, the increase in user charges for some public services was a landmark decision under the international financial assistance programme (although coupled with an increase in exemptions from these charges), and these were later reduced by the new government in early 2016. To account for the effect of these changes, the same statistical analysis is performed using out-of-pocket payments (last row of Table 1). We can see a downward trend in the amount of out-of-pocket payments both during and after the bailout. More precisely, Table 1 shows that while out-of-pocket payments by households during the troika years did not increase, this out-of-pocket expenditure does then increase but the pace of growth is nearly identical to the trend before the troika years.

In Table 1, we can therefore infer that there has been no reversal in austerity, as measured by the evolution in health expenditure. After the bailout, there was still fiscal consolidation in expenditure for care in hospitals (excluding day care) and for pharmaceuticals. Hence, the emerging picture is one of austerity falling upon providers of care within the scope of the NHS, with public hospitals and pharmaceuticals being particularly affected. There is not, however, evidence of the government shifting its public expenditure to households during this period.

Another important indicator of financial constraints faced by public hospitals is the amount of debt they create. This debt creation, and the subsequent immediate growth in arrears, has always represented one of the escape doors from budget limitations in the management of hospitals. Consequently, the total amount of arrears (payments due that exceed delays of 180 days) could be taken as a summary indicator of the insufficiency of hospital funds to meet their medical assistance needs. This indicator is available with monthly periodicity and is presented in Figure 4 (a sudden drop usually suggests that extra funds were made available).

At the start of the bailout, the existing hidden debts were brought into the accounting system. The drop observed in July 2012 is explained by the extra funds made available to regularise hospital debt. Subsequently, arrears had a monthly absolute growth of *circa* 30.8 million euro. From June 2014 to August 2019, and again excluding the effect of debt regularisation transfers, there was a monthly growth in arrears of 30.7 million euro. If we consider only the Costa I government, the mean absolute growth in arrears was 39.2 million euro per month. Therefore, the end of the international financial assistance programme did not stop the financial pressure on hospitals; quite the contrary. This finding again provides support for the argument that the socialist government pursued austerity by stealth. Another escape door for hospitals facing contraction is that of delaying the provision of services, with waiting times being used to avoid more health expenditure.[16] Figure 5 reports information on median waiting times for the most important types of surgeries and their recent evolution as an illustration of the general movement. It shows that the austerity years were associated with an increase in waiting times; however, the effect has not disappeared in more recent years and, in some cases, it is quite the opposite. This information again corroborates the austerity by stealth argument.

A final piece of information about service quality comes from the unmet medical needs indicator from the EU-SILC (European Union Statistics on Income and Living Conditions) survey. Figure 6 shows the percentage of citizens that had an unmet health care need due to costs, distance or waiting lists in the past year.[17] We can observe an increase in unmet needs during the austerity years (2011-2014), with a reversal afterwards – a similar evolution pattern is found in the EU. Hence, the austerity by stealth situation did not deter the patients' first contact with the NHS (or the health system, more generally), and the containment of public health expenditure occurred therefore through increased waiting times, and with increases in debt and arrears.

What emerges is that the cut in costs in both the bailout and post bailout periods caused a deterioration in the quality of public services and delayed services (together with a reduction in the profit of the pharmaceutical industry and pharmacies) but it did not leave people unattended on a large scale. Overall, we find important evidence in support of our argument that unrecognised austerity, i.e. austerity by stealth, has been pursued by the Socialist government to square the circle.

[16] Another option for hospitals is the reduction in investment and maintenance of equipment, but unfortunately no detailed analysis of ageing equipment and maintenance and replacement delays is publicly available. However, this possibility is very plausible if we look at the overall trend in investment.
[17] Although this indicator has been criticised for being subjective and not related to actual received care (for a discussion of this measure see Allin & Masseria 2009), it still provides useful information.

Conclusions

In this article, we bring some nuance to the narrative that suggests the Portuguese recovery - and the subsequent reduction of the debt and deficit - was made possible thanks to the ending of austerity, which gave rise to more growth and revenue. We argue and demonstrate that in addition to the more visible reversals of austerity policies, the government also pursued some ‘austerity by stealth’.

We show that these measures of austerity by stealth were implicitly accepted by the radical left parties whilst negotiating their agreements with the PS in 2015 and when voting on the annual budgets, in exchange for the adoption of a long list of more visible anti-austerity policies. These measures enabled the Portuguese government to reduce the country’s deficit in line with the EMU ceilings and, by the same token, to gain credibility with investors and lower the cost of interest-debt repayments.

We further look at the evolution of government spending and revenues and observe a shift from direct to indirect taxation revenue, and the continuity of low spending on health, education and investment. Given the increase in GDP, this continuity means that the relative weight of that spending had decreased. We also observe that from 2018-19 onwards the decline in spending on interest rates payments allowed the government to (partially) increase investments and health spending - without reaching the level of the pre-troika years however.

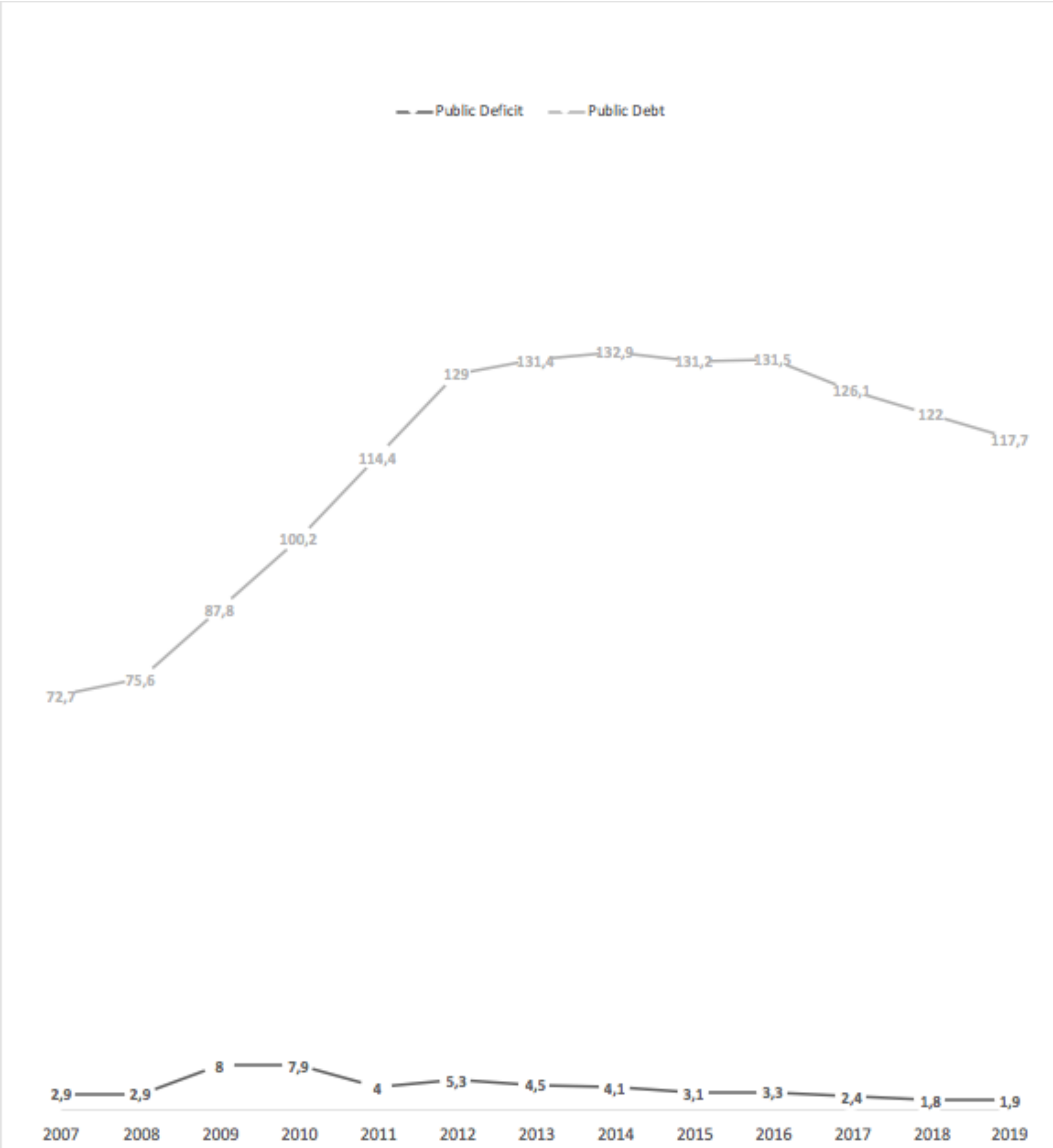
To glean a deeper understanding of what this decrease means, we take a closer look at one specific field: the health sector. There, we find evidence of a prolongation of austerity despite the rise in health workers’ wages and the cut in their working hours. However, the burden of this austerity was carried by hospitals and the pharmaceutical stakeholders rather than directly by households.

Finally, it should be noted that this strategy was electorally successful for the PS. Even though citizens were increasingly aware of the deterioration in public services, notably in health and transportation (a central issue in the 2019 campaign), the incumbent PS gained seats and votes in the election. On the left, the BE more or less replicated its (very positive) 2015 outcome, while the CDU - i.e. the PCP and the Greens, which had claimed the credit for visible spending during the legislature but blamed the PS for the cuts - suffered significant losses. This is a puzzling fact that warrants further research, but that may be explained, at least in part, by the fact that voters in a country that had just been bailed out now value the state's capacity to keep accounts in order.

A comparative analysis would help verify whether our findings can be applied in other countries that were equally hit by the economic crisis. Since the anti-austerity rhetoric was quite common in all Southern European countries in the post-crisis period, notably among the left or challenger parties, the present study on the relationship between responsiveness and responsibility and the strategy adopted by the governing parties to fulfil both should be replicated in further cases, and notably in those in which anti-austerity parties formed governments. The alarming decrease in public investment observed everywhere but especially in Southern Europe indicates that austerity by stealth is probably a widespread phenomenon.

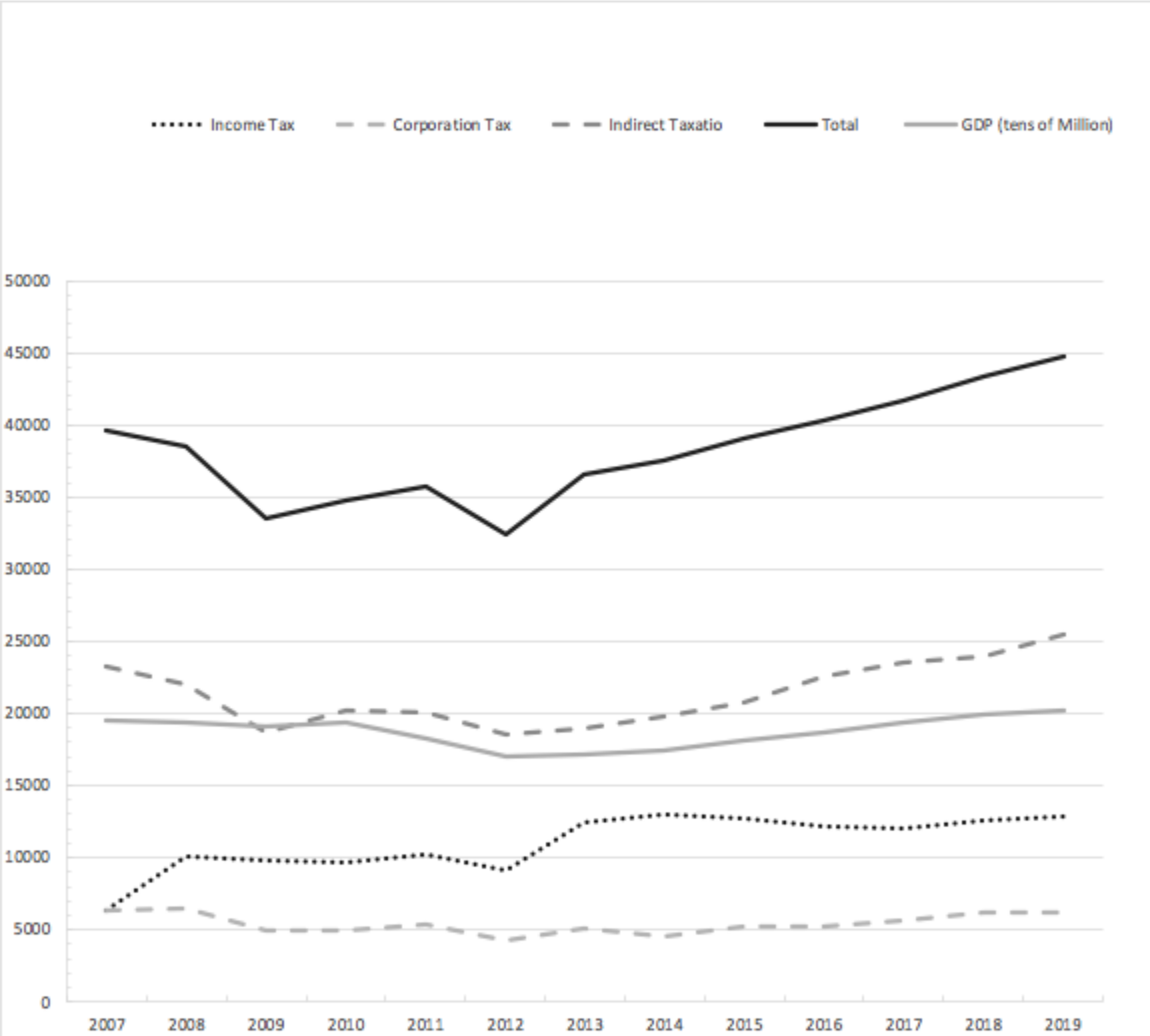
Tables and Figures

Figure 1: Evolution of Public Deficit and Debt in % of GDP



Source:DGO/MF, BP, INE, collected by Pordata.pt and consulted on 27th August 2020.

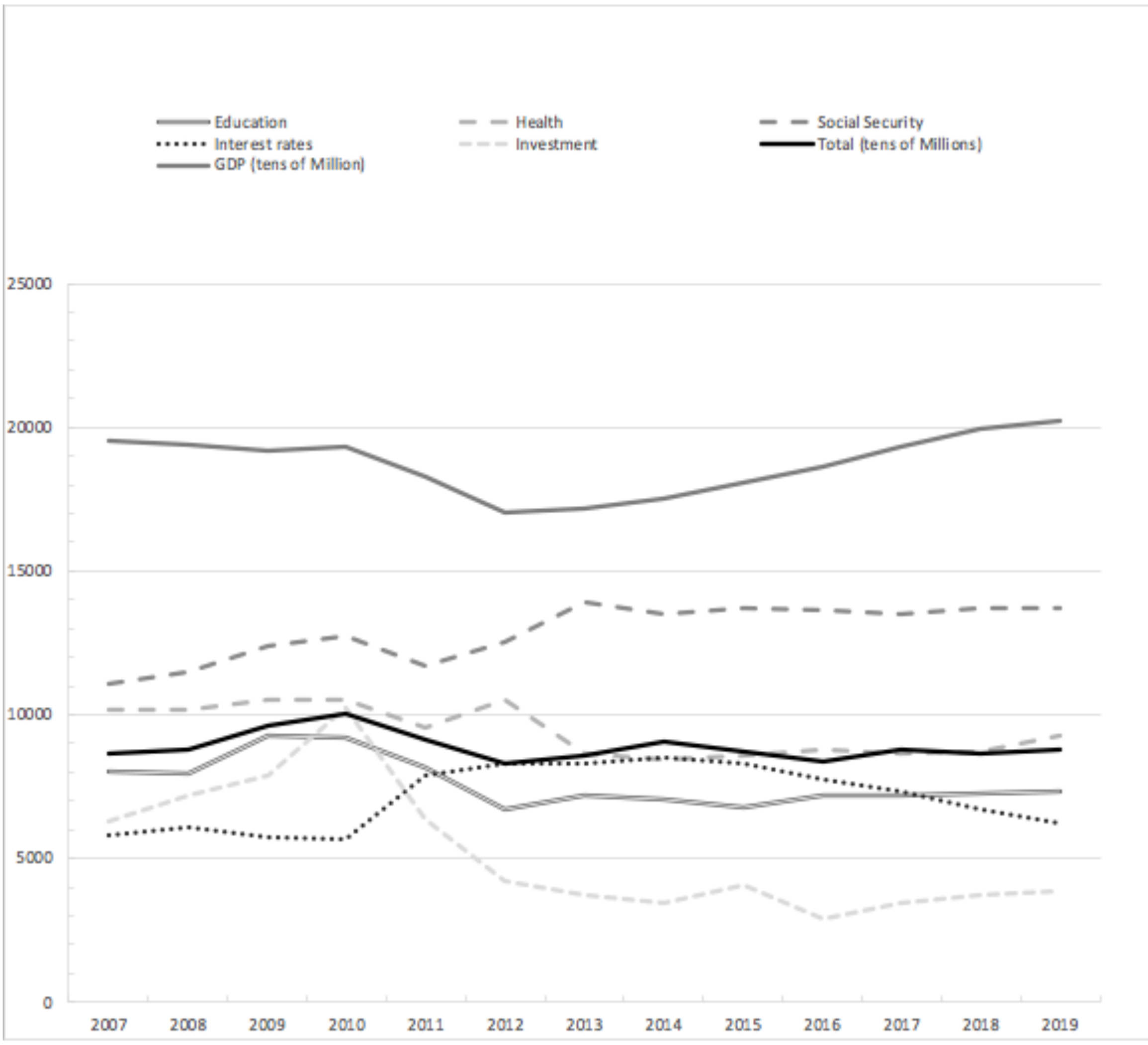
Figure 2: States Revenue, per given category, in Millions of Euros (constant price[18])



Source: Own elaboration from DGO / MF ('report on General State Account') and INE ('Annual Accounts'), collected by Pordata.pt and consulted on 27th August 2020.

[18] References prices are those of 2016. GDP is presented in tens of millions.

Figure 3: State Spending, per given category, in Millions of Euros (constant price[19])



Source: Own elaboration from DGO / MF ('report on General State Account') and INE ('Annual Accounts'), collected by Pordata.pt and consulted on 27th August 2020.

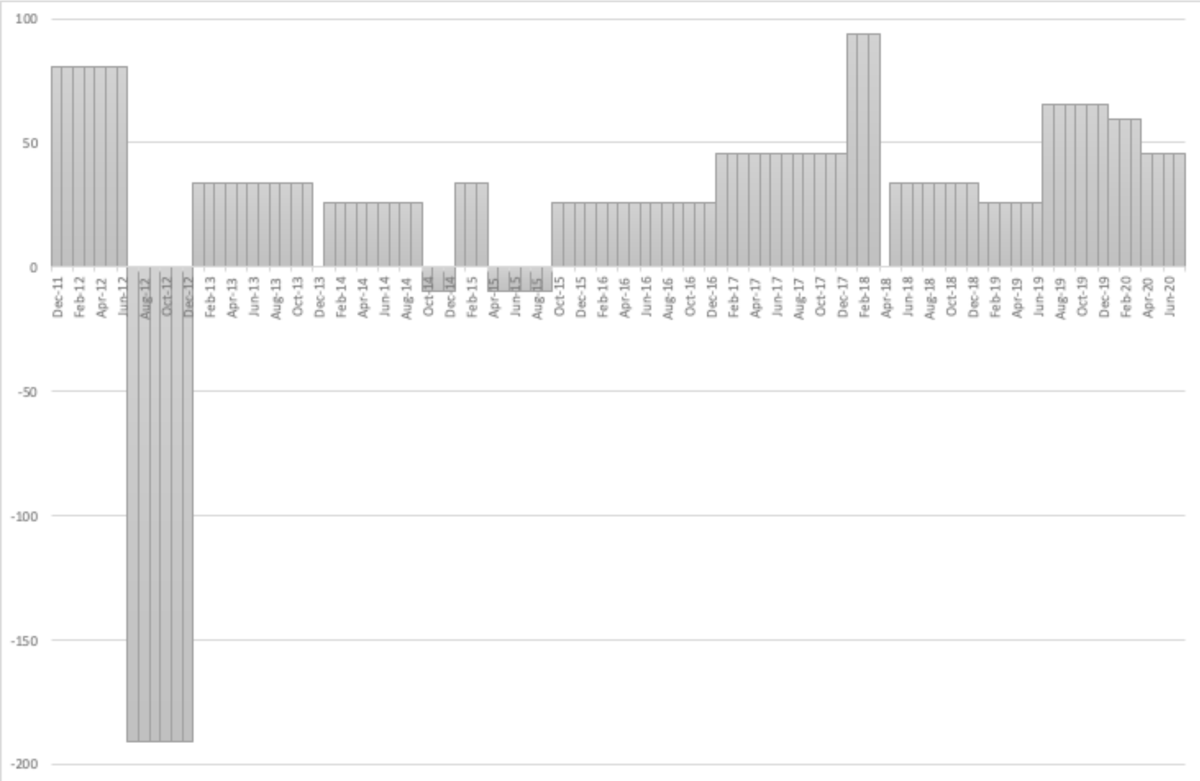
[19] References prices are those of 2016. GDP is presented in Tens of Millions.

Table 1: Main result of the regression analysis of the trends in expenditure for different categories

Dependent variable	**(a_1) 2011-2014**	**(a_2) 2015-2017**	**Test a_1=a_2 F(1,14))**	**Interpretation**
Public health expenditure	-144*	-166*	Does not reject	Austerity by stealth
Public inpatient expenditure	-27*	-28*	Does not reject	Austerity by stealth
Public hospital day care expenditure	2,8	2,7	Does not reject	No austerity impact
Public outpatient expenditure	-46*	-60*	Does not reject	Austerity by stealth
Public expenditure with pharmaceuticals	-43*	-47*	Does not reject	Austerity by stealth
Out-of-pocket payments by households (total)	-48*	-58*	Does not reject	Health system improvement

Note: * means statistically significant at the 5% level; a negative sign for coefficients means a lower growth compared with the trend in 2000-2010.
Source: own computation, based on INE – Health National Accounts.

Figure 4: Average monthly growth in arrears per trend period

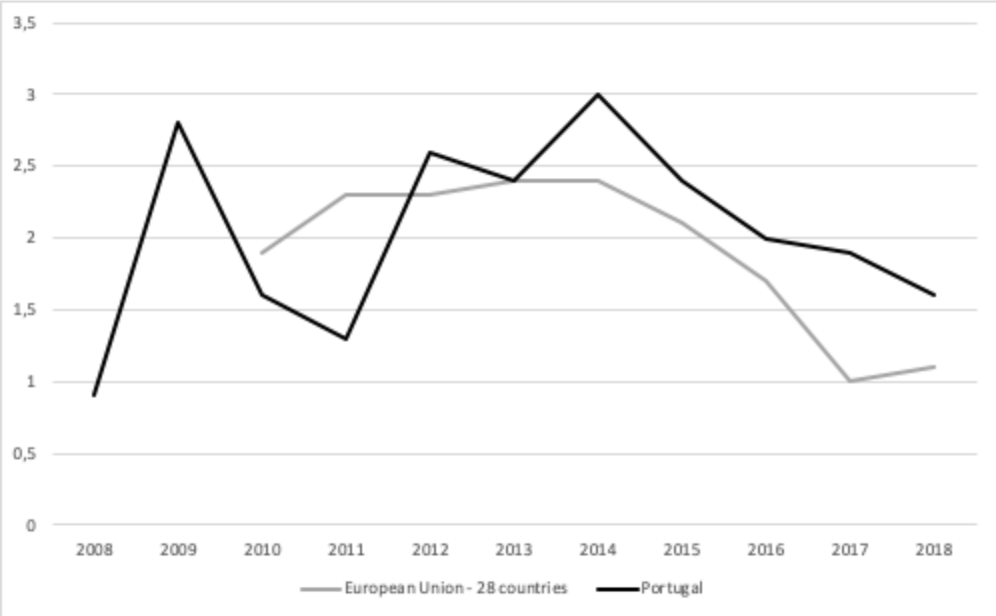


Note: equal values over consecutive months means the same average trend value applies.
Source: own computations, based on the values of monthly arrears by Direcção-Geral do Orçamento.

Figure 5: Median waiting times (surgery) in number of days

Source: Own elaboration from OECD Health Data 2019

Figure 6: Percentage of citizens that report an unmet need (due to services being too expensive) in the past year



Source: Own elaboration from Eurostat

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2. Junior Minister, PS Government, 18th May 2018.
3. Junior Minister, PS Government, 20th June 2018
4. Minister, PS Government, 23rd May 2018
5. Negotiator, BE, 07th November 2019.